Supreme Court of the United States

October Term, 1958

No. 708

[redacted]

Petitioner,

v.

[redacted]

Respondent.

BRIEF FOR PETITIONER

[redacted]

Attorney for Petitioner

[redacted]

[redacted]

SUBJECT INDEX.

PAGE

Brief Statement of the Issues 1

Official Report of Opinions Delivered 4

Grounds of this Court's Jurisdiction 4

STATEMENT OF THE CASE 5

FIRST. As to Portions of Actual Premiums Credited. 5

I. The principles which underlie mutual insurance on the level premium plan. 5

II. This clause of the law says nothing about dividends. It speaks only of portions of actual premiums received, which must not be confused with dividends. 6

III. The Treasury Department construed this clause of the law to apply to portions of actual premiums received in excess of cost of insurance on annual dividend policies only; but refused to apply it to like sums received in excess of cost of insurance on deferred dividend policies 7

IV. Annual dividend policies and deferred dividend policies defined and distinguished 7

V. The $8,189,918 was made up wholly of portions of actual premiums received from individual deferred dividend policyholders 9

PAGE

VI. This $8,189,918, made up of portions of actual premiums received from each individual deferred dividend policyholder, was distributed among and credited to each such individual policyholder, within the taxing year..... 11

VII. The petitioner carried these credited portions of premiums not as a part of its general funds but as a liability in a special fund for the sole use of the policyholders to whom they belonged. 16

Conclusions from These Facts..... 16

SECOND. As to Losses Actually Sustained by Amortization 17

Specification of Errors Relied upon..... 18

BRIEF OF THE ARGUMENT 20

FIRST. As to Portions of Actual Premiums Credited. 20

I. Summary of the Argument..... 20

II. The origin of this clause of the law discloses its purpose and intent..... 22

III. The aptness of the language used in this clause to do just what Congress intended by it to do and what the petitioner claims it does..... 27

IV. *Penn Mutual Life Insurance Co.* v. *Lederer* has nothing to do with the issue in this case. That case was about dividends, this is not..... 29

V. The *Penn Mutual* case controlled the decision of the trial court and misled a majority of the Court of Appeals who by their decision practically eliminated

PAGE

from the statute the word, credited, which was especially intended to apply to deferred dividend policies..... 30

VI. The over-payments were credited to each individual policyholder..... 33

VII. The credited over-payments are none the less credits because the policyholder may lose his credit by dying or lapsing his policy before the dividend date named in it..... 37

VIII. To hold that this clause applies to annual dividend policies only and not equally to deferred dividend policies is not merely contrary to the plain and unambiguous terms of the law, but discriminates (1) between taxpayers of the same class, and (2) between different groups of policyholders of the same taxpayer..... 39

SECOND. As to Losses Sustained by the Amortization of Securities..... 43

APPENDIX I. Revenue Act of 1913..... 48

APPENDIX II. Revenue Act of 1909..... 51

TABLE OF CASES.

PAGE

American Net & Twine Co. v. *Worthington*, 141 U. S. 468 37

Church of Holy Trinity v. *U. S.*, 143 U. S. 467..... 42
Converse v. *Northern Pacific*, 2 Fed. 2d 959..... 37

Fed. Stat. Annotated, Vol. 4, p. 254..... 23
Fink v. *Northwestern*, 267 Fed. 968..... 45

Gould v. *Gould*, 245 U. S. 151..... 37

Hawaii v. *Mankichki*, 190 U. S. 197..... 42
Haydenfeld v. *Dancy & Co.*, 93 U. S. 634..... 42
Herold v. *Mutual Benefit*, 201 Fed. 918..... 22

Knowlton v. *Moore*, 178 U. S. 41..... 41

Lau Ow Bew v. *U. S.*, 144 U. S. 47..... 42

Matter of Stevens, 187 N. Y. 471..... 44
Mutual Benefit v. *Herold*, 198 Fed. 199.....20, 22, 23

New York Ins. Law, Sec. 89..... 41
New York Ins. Law, Sec. 18..... 44
N. Y. L. I. Co. v. *Styles*, 14 App. Cas. 381..... 25
N. Y. Life & Trust Co. v. *Baker*, 38 A. D. (N. Y.) 417. 44
N. Y. Life & Trust Co. v. *Baker*, 165 N. Y. 484..... 44
Northwestern v. *Fink*, 248 Fed. 568..... 45

Park View v. *Herold*, 203 Fed. 876..... 37
Penn Mutual v. *Lederer*, 252 U. S. 523.....2, 20, 29
Penn Steel Co. v. *N. Y. C. Ry. Co.*, 198 Fed. 774..... 37

Revenue Act of 1913..... 48
Revenue Act of 1909..... 51

Smythe v. *Fish*, 23 Wall. 374..... 42
Spreckles Sugar Co. v. *McLane*, 192 U. S. 397..... 37

U. S. v. *Kirby*, 7 Wall. 482..... 42
U. S. v. *Merriam*, 263 U. S. 179..... 37
U. S. v. *Standard Brewery*, 251 U. S. 210..... 27

IN THE

Supreme Court of the United States.

No. 712.

OCTOBER TERM, 1925.

NEW YORK LIFE INSURANCE COMPANY,
Petitioner,

AGAINST

WILLIAM H. EDWARDS, as Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

BRIEF FOR PETITIONER.

Brief Statement of the Issues.

MAY IT PLEASE THE COURT,—

This action involves additional income taxes paid for 1913, and presents two questions,—

FIRST: The meaning and application of the following clause of the Revenue Act of 1913, Subdivision II-G(*b*) (38 Stat. at L. 114, Chap. 16 at page 172)* "and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual

* All that part of the Revenue Act of 1913 material to this dispute is printed at the end of this brief as Appendix I.

policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year".

In administering this law the Commissioner correctly did not include as income for the year such portions of actual premiums received from the petitioner's individual annual dividend policyholders as were paid back or credited to such individual policyholders, or were treated as an abatement of premium of such individual policyholders, within the taxing year; but the Commissioner refused to accord this same treatment to like portions of actual premiums received from individual deferred dividend policyholders and credited to such individual policyholders within the taxing year. This refusal made the petitioner's taxable income for the year appear to be $8,189,918 greater than the law allowed and increased its tax accordingly.

The trial court decided this question against the petitioner on the authority (R. 129 *et seq.*) of *Penn Mutual Life Insurance Co.* v. *Lederer*, 252 U. S. 523. The Court of Appeals held that (R. 167) "the question which was before the court in that case (the *Penn Mutual* case) is not the question which is before this court in the instant case"; and then, as I understand the opinion, proceeded to affirm the judgment of the trial court on the authority of the *Penn Mutual* case, MR. CIRCUIT JUDGE HOUGH dissenting.

In the *Penn Mutual* case, the insurance company sued to recover taxes paid under protest for failure to exclude from gross income dividends paid in 1913 on deferred dividend insurance, composed of (1) over-payments of premiums credited in all the years of the policy, plus (2) interest accumulations thereon during the period the policyholder's money rested with the company to his credit, plus (3) the policyholder's proportionate share of the accumulated over-payments made by other policyholders of his class who had died or defaulted in the payment of premiums. The court held that this money paid back in 1913 on the dividend date named in the policy constituted a dividend, and hence was

not deductible because the law says,—insurance companies shall deduct "the sums *other than dividends* paid within the year on policy and annuity contracts".

But this $8,189,918 in dispute here is in no sense dividends. It contains no interest, no over-payments of other policyholders. It is all over-payments of premiums of the several individual deferred dividend policyholders received from them as a part of their premiums in 1912, the amount of which over-payments was ascertained at the annual accounting in 1913, and distributed and credited to each individual deferred dividend policyholder in 1913,—just as the amount of the annual dividend policyholders' like 1912 over-payments was ascertained at the same annual accounting in 1913, and distributed and credited to each individual annual dividend policyholder, unless he elected, as he practically always did elect, to have his over-payment returned to him or treated as an abatement of his premium in 1913. The law expressly states that such over-payments shall not be included in income.

SECOND: Under that clause of said law which authorizes a taxpayer to deduct from gross income "all losses actually sustained within the year and not compensated by insurance or otherwise", the petitioner deducted from gross income the loss sustained during the year by amortizing its securities purchased at a premium; but the Commissioner disallowed the deduction. The trial court held with the petitioner on this question, but the Court of Appeals reversed the judgment on the defendant's cross writ of error, MR. CIRCUIT JUDGE HOUGH dissenting.

The case involves no question of payment under protest, proper appeal, or other legal requirement for maintaining the suit. It was tried on the pleadings and an agreed statement of facts.

Official Report of Opinions Delivered.

The trial court's opinion is found in 3 Fed. 2d., 280, and in the record commencing at page 126.

The Circuit Court of Appeals' opinion is not yet officially reported, but is printed in the record commencing at page 156.

Grounds of this Court's Jurisdiction.

(1) Date of trial court's judgment, December 15, 1924 (R. 22). Date of Circuit Court of Appeals' judgment, August 6, 1925 (R. 177).

(2) This is a civil case and it arises under a law providing for internal revenue, to wit, under the Revenue Act of 1913, entitled "An Act to reduce tariff duties and to provide revenue for the Government and for other purposes", approved October 3, 1913, imposing an income tax on corporations, 38 Stat. at L. 114, Chap. 16, and especially arises under Section II-G(*b*) at page 172 of said Act. The petitioner brought the case against the Collector to recover $90,556.19 additional income taxes paid for the year 1913, and it involves the construction and application of said Section II-G (*b*) of said Revenue Act. The case is here on Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

(3) The statutory provisions under which jurisdiction is invoked are *The Judicial Code*, Section 24, Fifth, and Section 240 as amended by the Act of February 13, 1925.

STATEMENT OF THE CASE.

First.

As to the clause of the law which says,—"and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year".

I.

The principles which underlie mutual insurance on the level premium plan.

"The plaintiff is a mutual company, transacting the business of life insurance on the purely mutual, level premium, plan, and has no shares of capital stock nor stockholders" (R. 26, f. 76).

It is fundamental in the business of life insurance on the mutual, level premium, plan that each policyholder is entitled to his insurance at cost; but each policyholder pays yearly in advance an estimated sum, called premium and believed to be more than cost, which is reduced to cost when the accounting taken after the end of each calendar year discloses what was cost. The over-payment ascertained by the accounting belongs to the policyholder. It is the portion of actual premium received from each individual policyholder in excess of cost, and is paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, in the year the accounting is made.

It is this sum paid in excess of cost to which this clause of the law applies and which is the important item in dispute in this case.

II.

The Court will notice that this clause of the law says nothing at all about dividends. It speaks only of portions of actual premiums received, which must not be confused with dividends.

In administering this law, mistakes have resulted from confusing with dividends "portions of actual premiums received". This confusion is harmless when applied to annual dividend policies, because on those policies dividends and portions of actual premiums received in excess of the cost of insurance are the same in amount. But such confusion is not merely not harmless, but is very harmful, when applied to deferred dividend policies, because on those policies, as I shall later show, dividends on the one hand and portions of actual premium received in excess of the cost of insurance on the other are very different sums;—they differ in their amount, in their source, and in the policies to which they apply. Besides, the law expressly says that dividends shall not be deducted from gross income,—insurance companies shall deduct "the sums other than dividends paid within the year on policy and annuity contracts".

III.

The Treasury Department construed this clause of the law to apply to portions of actual premiums received in excess of the cost of insurance on annual dividend policies only; but refused to apply it to like sums received in excess of the cost of insurance on deferred dividend policies.

See Supplemental Memorandum attached to petitioner's Tax Return (R. 30, f. 88); paragraph Fifth of the Agreed Statement of Facts (R. 30); and Treasury Department's letters of March 28, 1917 (R. 32), and of June 20, 1918 (R. 34).

IV.

Annual dividend policies and deferred dividend policies defined and distinguished.

An annual dividend policy is one in which the portion of actual premium received from each individual policyholder in excess of the cost of insurance is each year ascertained and is that year either paid back, or credited, or treated as an abatement of premium.

A deferred dividend policy is one in which the portion of actual premium received from each individual policyholder in excess of the cost of insurance is each year ascertained but is in that year credited only; the credited overpayment is accumulated at interest, and is paid back as a dividend with interest accumulations on the dividend date

named in the policy,—usually twenty years but sometimes ten, fifteen or other period of years, after the insurance took effect,—together with the policyholder's share of the credited over-payments of the policyholders of his class whose policies were not in force on the dividend date named therein.

Exhibit A, commencing on page 98, is a representative annual dividend policy, and Exhibit B, commencing on page 110, is a representative deferred dividend policy.

To illustrate "the exact facts relating to all policies", Section Fifteenth of the Agreed Statement of Facts, commencing on page 45, states "what actually happened in the case of two representative policies taken out in the same year, at the same age, and for the same amount" on the ordinary life plan, one providing for annual dividends and the other for deferred dividends. This illustration shows,——

1. That the premiums for each of the two policies were the same;

2. That with respect to each of them, as of all policies, the petitioner made at one and the same time an annual accounting;

3. That the annual accounting disclosed the exact sum over-paid by each individual policyholder, and that the amount of the over-payment was precisely the same for each $1,000 of insurance under a deferred dividend policy as under an annual dividend policy of the same class taken out at the same age;

4. That the annual dividend policyholder's ascertained over-payments were, in the year of the accounting, paid back, credited or treated as an abatement of premium; but the deferred dividend policyholder's over-payments were that year credited only.

Hence, the only difference between these two forms of contract lies in the way in which they provide for dispos-

ing of the portions of actual premiums received each year in excess of the cost of insurance. Under the annual dividend policy these sums when ascertained are, at the option of the policyholder, paid back, or credited, or treated as an abatement of premium. Under the deferred dividend policy the policyholder has reserved no such option; his over-payments when ascertained are credited only. In all other respects the two contracts are alike.

V.

This $8,189,918 was made up wholly of portions of actual premiums received from individual deferred dividend policyholders.

1. "The Table Rate of premium provided for in life insurance on the mutual, level premium, plan is calculated, First, by adopting an accepted table of mortality showing the death rate for each age of life; and Second, by adopting an assumed rate of interest such as the Company may safely expect to realize upon its invested assets for the duration of all its policies. With these two factors it is calculated just what sum each insured must pay yearly in advance so as to put the Company in funds with which to pay all outstanding policies as they become claims, provided deaths occur exactly in accordance with the Table of Mortality, and also provided the rate of interest earned on the Company's invested funds is exactly the same as the rate assumed in calculating its premiums. The sum ascertained in this way is called the net or mathematical premium. But the net or mathematical premium is not the full amount each member must pay into a going concern, because it contains no provision for expense of management and unforeseen contingencies such as excess mortality, diminished interest, investment losses, increased

taxation and the like; therefore, to provide for these there is added to the net or mathematical premium a sum technically called 'loading'. The net or mathematical premium plus the loading constitutes the Company's Table Rate of Premium or level premium, and is the estimated sum named in the policy as premium to be paid in advance and adjusted to cost when cost is known, and is the maximum sum which the Company can ever require the insured to pay" (R. 40, f. 118 *et sequor*).

2. "To find out what was the actual cost of insurance for the year, the plaintiff at the end of each calendar year takes an account of its business for the year. * * *

"The plaintiff's policyholders paid it in 1912 the premiums called for in their respective policies on or about the several dates they became due and as the plainitff received these premiums it at once credited the amount of the premiums to each individual policyholder in a separate premium account kept with him. In the accounting made at the end of the year, the plaintiff ascertained the amount of its total receipts for the year, from which it deducted (1) its policy claims paid for the year, (2) its current expenses, (3) the sum required to increase its reserves, and (4) the amount required to increase the sum held to meet contingencies, and all sums received in excess of these four items constituted the amount of over-payments of premiums made during 1912 which the plaintiff held for return to said policyholders in accordance with the terms of their several policies. As soon as practicable after the 31st day of December, 1912, the plaintiff took said account of its business for the year and thereby ascertained, and the fact was, that its said policyholders had over-paid it for the year the aggregate net sum of $13,900,061.00, consisting of over-payments made by annual dividend policyholders aggregating $5,710,143.00, and over-payments made by deferred dividend policyholders aggregating $8,189,918.00" (R. 41, f. 122 *et seq.*).

Thus the accounting which the plaintiff made in the taxing year disclosed that the total amount of portions of actual premiums received by it the year before from all its policyholders in excess of the cost of their insurance was $13,900,061. Of this sum $5,710,143 was made up of portions of actual premiums received from individual annual dividend policyholders, and $8,189,918 was made up of portions of actual premiums received from individual deferred dividend policyholders.

VI.

This $8,189,918, made up of portions of actual premiums received from each individual deferred dividend policyholder, was distributed among and credited to each such individual policyholder, within the taxing year.

1. "Said over-payments of premiums made by the plaintiff's annual dividend policyholders it distributed among those policyholders by a mathematical calculation based on the amount of annual dividend insurance in force, the year of issue of the several policies, the plan of the policy,—that is, whether it was ordinary life, limited payment life, joint life, endowment or other form of policy,—and the age at issue. By this calculation was ascertained the amount of over-payment made by each insured on each one thousand dollars of insurance for each year of issue on each policy plan and at each age at issue. The over-payment so ascertained, when multiplied by the number of thousands of dollars of annual dividend insurance in each year of issue, on each insurance plan and at each age at issue, equaled precisely $5,710,143 when the products of such multiplication were all added together" (R. 42, f. 126 *et seq.*).

2. "By a like mathematical calculation, the plaintiff ascertained the amount of over-payment made by each deferred dividend insured on each one thousand dollars of insurance for each year of issue on each insurance plan and at each age at issue. The over-payment so ascertained, when multiplied by the number of thousands of dollars of deferred dividend insurance in each year of issue on each insurance plan and at each age at issue, equaled precisely said sum of $8,189,918, when the sums so multiplied were all added together" (R. 44, f. 130).

3. After ascertaining the portion of actual premium received from each individual deferred dividend policyholder in excess of the cost of insurance, the petitioner credited the sum so received to each such individual policyholder within the taxing year, by entering it in the proper place in its record kept for this purpose (R. 44, f. 131).

4. Exhibit 5 (R. 119), reproduced on the next page of this brief from the plates used in printing the Agreed Statement of Facts, is a photographic copy of one page of the petitioner's form in use for crediting these over-payments, reduced in size four inches vertically and two inches horizontally, and shows the annually ascertained and credited over-payment on each one thousand dollars of insurance on every deferred dividend policy issued in the year 1905 on the ordinary life plan at all ages with respect to the sixth, seventh, eighth and ninth annual premiums, and shows also the amount of the accumulated over-payments upon each one thousand dollars of said insurance held in each of said years (R. 47, f. 140). Said Exhibit 5 "is a typical record of all deferred and annual dividend policies of each year of issue, insurance plan and age at issue" (R. 48, f. 143).

RATES ACCUMULATED WITH BENEFIT OF SURVIVORSHIP ON BASIS C. P. MORTALITY WITH INTEREST AT 4%. FOR APPORTIONMENT OF INTERIM SURPLUS.

Year of Issue 1905 Kind Life Oray. Dividend Class

AGE	Share per M Dec. 31, 1909, Inc. 1910 Div.	6 ...Year Div. Rate per M, 1911	Share per M Dec. 31, 1910, Inc. 1911 Div.	7 ...Year Div. Rate per M, 1912	Share per M Dec. 31, 1911, Inc. 1912 Div.	8 ...Year Div. Rate per M, 1913	Share per M Dec. 31, 1912, Inc. 1913 Div.	9 ...Year Div. Rate per M, 1914	Share Dec. Inc.
21	9 59	2 88	12 71	3 04	16 64	3 40	20 81	3 66	
22	9 79	2 94	13 48	3 21	17 50	3 48	21 76	3 74	
23	10 03	3 01	13 50	3 26	17 40	3 56	21 76	3 82	
24	10 26	3 08	13 81	3 36	17 81	3 64	22 27	3 92	
25	10 51	3 15	14 14	3 44	18 23	3 72	22 81	4 01	
26	10 77	3 23	14 50	3 52	18 64	3 82	23 39	4 11	
27	11 02	3 31	14 84	3 61	19 13	3 91	23 94	4 21	
28	11 31	3 39	15 22	3 70	19 64	4 01	24 57	4 32	
	11 61	3 48	15 62	3 80	20 15	4 11	25 21	4 43	
	11 93	3 58	16 07	3 90	20 73	4 23	25 97	4 55	
31	12 25	3 67	16 50	4 01	21 29	4 34	26 65	4 68	
32	12 61	3 78	16 98	4 12	21 90	4 46	27 41	4 81	
33	12 97	3 89	17 47	4 24	22 55	4 59	28 22	4 95	
34	13 36	4 00	17 99	4 36	23 21	4 73	29 05	5 09	
35	13 77	4 12	18 55	4 50	23 94	4 87	29 98	5 25	
36	14 19	4 25	19 12	4 64	24 68	5 02	30 91	5 41	
37	14 66	4 38	19 74	4 78	25 49	5 18	31 92	5 58	
38	15 14	4 53	20 41	4 94	26 35	5 35	33 02	5 76	
39	15 64	4 68	21 09	5 10	27 24	5 53	34 13	5 96	
40	16 20	4 84	21 83	5 26	28 20	5 72	35 36	6 16	
41	16 78	5 01	22 63	5 46	29 24	5 92	36 68	6 38	
42	17 41	5 19	23 47	5 66	30 33	6 13	38 04	6 61	
43	18 07	5 38	24 37	5 87	31 51	6 36	39 54	6 85	
44	18 76	5 58	25 32	6 09	32 75	6 60	41 12	7 11	
45	19 48	5 80	26 29	6 33	34 01	6 86	42 74	7 38	
46	20 30	6 03	27 41	6 58	35 47	7 13	44 59	7 68	
47	21 13	6 28	28 55	6 85	36 97	7 42	46 50	7 99	
48	22 04	6 54	29 79	7 13	38 09	7 72	48 55	8 32	
49	23 01	6 81	31 11	7 45	40 34	8 06	50 81	8 67	
50	24 04	7 11	32 52	7 76	42 20	8 40	53 17	9 05	
51	25 18	7 42	34 09	8 16	44 27	8 77	55 83	9 43	
52	26 35	7 76	35 69	8 56	46 36	9 17	58 54	9 88	
53	27 61	8 12	37 44	8 96	48 70	9 59	61 56	10 33	
54	28 97	8 50	39 32	9 27	51 19	10 04	64 76	10 82	
55	30 46	8 90	41 37	9 72	53 94	10 57	68 34	11 33	
56	32 03	9 34	43 58	10 19	56 53	11 04	72 13	11 89	
57	33 73	9 80	45 79	10 69	59 85	11 58	76 24	12 48	
58	35 57	10 30	48 07	11 24	63 44	12 17	80 81	13 11	1 61
59	37 55	10 83	51 33	11 81	67 19	12 80	85 77	13 78	1 07
60	39 70	11 39	54 27	12 43	71 31	13 47	91 27	14 50	1 14
61	42 01	12 00	57 54	13 09	75 51	14 18	97 27	15 27	1 22
62	44 50	12 65	61 07	13 80	80 67	14 95	103 85	16 10	1 31
63	47 23	13 45	64 96	14 56	86 02	15 77	111 17	16 95	1 40
64	50 21	14 09	69 31	15 37	92 12	16 65	119 36	17 93	1 57
65	53 49	14 88	73 99	16 24	98 60	17 59	128 39	18 94	1 64

5. Now let us see how this Exhibit 5 and the volume of which it forms one page, and the other like volumes made from year to year, is a perfect credit to each individual policyholder of the portion of actual premium received from him in excess of cost.

Exhibit 5 is the over-payment credit for the sixth, seventh, eighth and ninth years to ordinary life policies taken out in 1905. 1913 was the eighth year of all such policies. Hence, in the column headed "8 year Div. Rate per M. 1913" is the over-payment of premium paid in 1912 and credited in 1913. Therefore, Exhibit 5 shows that each individual deferred dividend policyholder whose policy was taken out in 1905 on the ordinary life plan was credited in 1913 with an over-payment of $3.40 for each $1,000 of his insurance if he was age 21 when he took out his policy; with an over-payment of $3.48 if he was age 22; with an over-payment of $3.56 if he was age 23, and so on for all ages; and every other policyholder on every other plan was similarly credited (R. 43 *et seq.*). These individual credits (R. 44, f. 130) "when multiplied by the number of thousands of dollars of deferred dividend insurance in each year of issue on each insurance plan and at each age at issue, equaled precisely said sum of $8,189,918 when the sums so multiplied were all added together."

Thus did every penny of this $8,189,918 consist of portions of actual premium received from individual deferred dividend policyholders which were credited to such individual policyholders within the taxing year.

6. To illustrate "the exact facts relating to all policies" (R. 45) paragraph Fifteenth of the Agreed Statement of Facts gives from the petitioner's records the true history of two policies, each taken out in the same year, 1905, at the same age, 35, on the same plan, ordinary life, one an annual dividend policy and the other a deferred dividend policy. This illustration demonstrates that there is no difference between the two forms of contract except that

on the annual dividend policy the over-payment made in 1912, the amount of which was ascertained by the accounting taken after the end of 1912, was in 1913 paid back, credited or treated as an abatement of premium at the option of the policyholder; whereas the like over-payment on the deferred dividend policy was credited only.

On each of these two policies, the over-payment made in 1912 was ascertained at the accounting in 1913 to be $4.87 for each $1,000 of insurance (R. 45, f. 135 and R. 46, f. 136) and was credited in 1913 on Exhibit 5 in the column headed "8 year Div. Rate per M, 1913", on the horizontal line in that column opposite the figures 35, which was the age at issue.

7. The volume in which is credited the portions of actual premium received in excess of cost is in constant use as is shown by the frayed and worn page photographed and identified in this record as Exhibit 5.

For example, policyholders often inquire of the petitioner the amount of their credited over-payments. The petitioner answers these inquiries on a form in use for this purpose (R. 50) in which it gives him the amount of his accumulated over-payments at the beginning of the year in which the inquiry is made, the over-payment credited that year, the rate of interest his over-payments are earning, and the amount which will be held to his credit at the end of the year. The data for giving this information the petitioner obtains (R. 51) from its record of over-payment credits of which Exhibit 5 is a sample.

VII.

Nor did the petitioner carry these credited portions of premium as a part of its general funds. On the contrary, it carried them as a liability in a special fund for the sole use of the policyholders to whom they belonged.

Each year when the petitioner ascertained the portion of actual premium received from each individual deferred dividend policyholder in excess of the cost of his insurance, and credited him with it in its record kept for this purpose shown by Exhibit 5, the petitioner might have stopped there and let the total amount of the credited sums go into its general funds. But it did not do this. On the contrary, recognizing the true ownership of these credited sums, the petitioner maintained a special account into which it merged them, and it carried them and their interest accumulations in this separate account as a liability for the sole use and benefit of the several individual policyholders to whom they belonged (R. 44, f. 131 *et seq.*).

From These Facts the Court Will Notice,—

First: That the entire sum in dispute here consists only of such portions of actual premium received from individual deferred dividend policyholders as were credited to such individual policyholders within the taxing year, and which the law so plainly says life insurance companies shall not include as income.

Second: That the cost of insurance was the same for all insured of the same class and equal expectation of life, whether the policy was on the annual or on the deferred dividend plan. That the portions of actual premiums received in excess of cost were the same, the amount of them was ascertained at the same time, and they were distributed among the individual policyholders in the same way and at the same time.

THIRD: That the portions of actual premiums received from individual deferred dividend policyholders and credited to them within the taxing year were in every way the same as the like over-payments of annual dividend policyholders which were paid back, or credited, or treated as an abatement of premium of such policyholders, within the taxing year, and to which alone the Treasury Department gave the benefits of this clause of the law.

FOURTH: That not to include as income portions of actual premiums received from and paid back or credited to or treated as an abatement of premium of annual dividend policyholders and to refuse to accord to them this same treatment when received from and credited to deferred dividend policyholders is not merely to disregard and clearly to violate the plain meaning and intent of this law, but discriminates between policyholders who pay the same premium for the same insurance, and who in a mutual company are entitled to the same treatment; and also discriminates between mutual companies, because some of them have only issued annual dividend policies while other like mutual companies have issued both annual and deferred dividend policies.

FIFTH: There is nothing in the law to justify, much less to require, this discrimination. The law is general in its terms and applies to all policyholders alike. It accords to a deferred dividend policyholder precisely the same treatment of the portion of actual premium received from him and credited to him within the taxing year that it does to the like over-payment of an annual dividend policyholder.

Second.

As to losses actually sustained within the year and not compensated by insurance or otherwise.

The petitioner (R. 54, f. 162) "owns a large amount of securities which it purchased at a premium. It amortizes its securities, and as a result of amortization entered upon its books during the year 1913 as a loss sustained during the year several sums which aggregate $332,466.72. This amount so claimed as a loss represented the yearly proportion of the

difference between par which the plaintiff would eventually receive upon securities owned by it, if it held such securities until maturity, and the purchase price above par."

For example, the petitioner purchased a $1,000 bond which matured in ten years and paid for it $1,100. At maturity the petitioner would receive $1,000 only, thus losing $100. This loss it distributes over the ten years and charges itself each year with the yearly proportion of the loss.

The aggregate of these losses in the taxing year, $332,466.72, the Commissioner refused to allow as a deduction. The trial court sustained the petitioner's claim on this question (R. 136), but on the respondent's cross writ of error (R. 151) the Court of Appeals reversed the judgment (R. 166), JUDGE HOUGH dissenting.

SPECIFICATION OF ERRORS RELIED UPON.

The plaintiff relies upon each of the following several assignments of error (R. 141),—

FIRST: The Court erred in refusing to give the first instruction requested by the plaintiff which was as follows,—

> "The jury is instructed to render a verdict for the plaintiff for $81,189.18 on account of the item referred to and described in paragraph VIII(*a*) of the plaintiff's complaint and in paragraphs First to Twentieth, both inclusive, of the Agreed Statement of Facts, with six per cent interest thereon from August 5, 1918."

SECOND: The Court erred in refusing to give the second instruction requested by the plaintiff which was as follows,—

> "The jury is instructed that portions of actual premiums received by the plaintiff from its several individual policyholders whose policies were on what is known as the deferred dividend plan were credited to such individual policyholders during said taxing year in the aggregate sum of $8,189,918 which should not have been included as income for said year; but the Commissioner of Internal Revenue included them, and assessed and collected from the plaintiff on account thereof accordingly the sum of $81,899.18 which forms a part of the total tax complained of, and the plaintiff

is entitled to recover from the defendant the said sum of $81,899.18 with interest thereon at six per cent per annum from the 5th day of August, 1918."

THIRD: The Court erred in refusing to give the third instruction requested by the plaintiff which was as follows,—

> "The jury is instructed that a portion of a premium credited to the individual policyholder who paid it to the plaintiff does not mean that the company must keep a debit and credit ledger account with each insured to entitle itself to the benefits of the non-inclusion clause contained in the law. If a policyholder paid his premium and the company credited him on its records with the amount of the payment and the account taken in the taxing year disclosed that he overpaid for the previous year and shows the amount of the over-payment, then that constituted a credit to him for the sum overpaid."

FOURTH: The Court erred in refusing to give the fourth instruction requested by the plaintiff which was as follows,—

> "A credit was made to an individual policyholder if the account taken in the taxing year disclosed that he over-paid his previous annual premium and if the company so kept its records as to show at all times what the amount of such over-payment was."

FIFTH: The Court erred in its instruction to the jury as follows,—

> "Gentlemen of the jury, the Court instructs you to render a verdict for the defendant on that claim of the plaintiff for $81,899.18 which is referred to and described in paragraph VIII(*a*) of the plaintiff's complaint and in paragraphs First to Twentieth, both inclusive of the Agreed Statement of Facts."

And further assigns here the following error committed by the Court of Appeals,—

SIXTH: The Court of Appeals erred in reversing on the respondent's cross-writ of error the judgment of the Trial Court in respect of the right to deduct from gross income losses actually sustained within the year and not compensated by insurance or otherwise in amortizing securities purchased at a premium.

BRIEF OF THE ARGUMENT.

First.

As to the clause "and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year".

I.

Summary of the Argument.

This clause of the law was framed to meet the opinion of the court in *Mutual Benefit Life Insurance Company* v. *Herold*, 198 Fed. 199, affirmed in January 1913 on the opinion of the trial court in which with "fullness and ability" the court discussed the true nature of mutual insurance on the level premium plan, and concluded that over-payments of premium did not "in any wise, or to any extent, represent earnings or profits received by the company so as to constitute it a part of its income". Hence, as the Congress in 1913 was framing a law to tax income and income only, it added this clause to the Corporate Excise Tax Act of 1909* to exclude from income all over-payments of premiums, because the court had shown in the *Mutual Benefit* case they were not income of the company.

The clause describes with technical accuracy the sum in dispute here,—portions of actual premiums received from individual policyholders which were credited to such individual policyholders within the taxing year.

Penn Mutual Life Insurance Co. v. *Lederer*, 252 U. S. 523, which the respondent has hitherto so effectively urged

* Appendix II is the Corporate Excise Tax Act of 1909.

upon the court as an authority in this case, has in fact no bearing upon the issue here. For that case involved dividends, and dividends only. This case does not involve dividends. It involves over-payments of premiums and over-payments only, which are very different from dividends.

The accounting made in 1913 disclosed that the petitioner's deferred dividend policyholders over-paid it in 1912 $8,189,918. This sum the petitioner distributed among its individual deferred dividend policyholders (R. 42 *et seq.*) by a mathematical calculation based on the amount of deferred dividend insurance in force, the year of issue of the several policies, the plan of the policy, and the age at issue. By this calculation was ascertained the amount of over-payment made by each individual deferred dividend policyholder on each one thousand dollars of insurance for each year of issue, on each insurance plan, and at each age at issue; and the over-payment was credited to each individual policyholder on the form in use for this purpose of which Exhibit 5 at page 119 is a sample.

The credited over-payments are no less true credits because a policyholder may lose them by dying or lapsing his policy before the date named therein for returning to him his credited over-payments. The law says they shall not be included in income if they are portions of actual premiums received which are credited to individual policyholders within the taxing year. The law contains no limitation nor qualification, and in a taxing statute which like this is plain and clear in all its terms the court should make none.

To hold, as the Commissioner holds, that, in its practical effect, this clause of the law applies to annual dividend policies only and not equally to deferred dividend policies, is not merely contrary to the plain and unambiguous terms of the law, but discriminates (1) between taxpayers of the same class and (2) between different groups of policyholders of the same taxpayer. A taxing statute will not be so construed if another and more reasonable interpretation is present in

the statute. Much less will a taxing statute be so construed in which there is no ambiguity, and which, if enforced according to its plain terms, puts all companies and all policyholders on a basis of exact equality as Congress intended this clause to do.

II.

The origin of this clause of the law discloses its purpose and intent.

This clause is one of the few additions to the Corporate Excise Tax Act of 1909 which Congress made in passing the Revenue Act of 1913. It is worded with great skill to do precisely what we are here claiming for it.

Why did Congress add this clause to the Corporate Excise Tax Act of 1909 and intend to do by it what we here claim it does? Because Congress was enacting a law to tax income. The Federal Court had lately held and demonstrated that these over-payments were not income of the company; and as Congress was authorized to tax income only and had no power, without apportionment, to tax something that was not income, it framed this clause to exclude from income all these over-payments of premium.

January 27, 1913, the United State Circuit Court of Appeals of the Third Circuit affirmed the judgment of the United States District Court for the District of New Jersey rendered by MR. DISTRICT JUDGE CROSS in the case of *Mutual Benefit Life Insurance Company* v. *Herold,* 198 Fed. 199, involving the true nature of these over-payments, and in doing so the Court of Appeals said,—

> "We need not discuss the subject; that duty has been performed by JUDGE CROSS with such fullness and ability that we cannot do better than adopt his opinion".
>
> *Herold* v. *Mutual Benefit Life Ins. Co.,* 201 Fed. 918.

Now let us see what JUDGE CROSS said that the Court of Appeals thus approved and made its own.

The Mutual Benefit Life Insurance Company was, like the petitioner, a mutual company transacting the business of life insurance on the purely mutual, level premium, plan, and had no shares of capital stock nor stockholders.

The Corporate Excise Tax Act of 1909 authorized insurance companies to deduct from gross income "the sums *other than dividends* paid within the year on policy or annuity contracts".

Federal Statutes Annotated, Vol. 4, p. 255.

Nothwithstanding this clause of the law which prohibited the deduction of dividends from gross income, the Mutual Benefit, in making its return under the Corporate Excise Tax Act of 1909, deducted from its gross income the aggregate amount of dividends paid by it during the taxing year by treating them as an abatement of the premiums of the policyholders to whom the dividends were due, the Company receiving only the difference between the table rate of premium and the amount of the dividend.

Because the 1909 statute expressly prohibited the deduction of dividends, the Commissioner disallowed the deduction and assessed and collected from the Mutual Benefit an additional tax accordingly. The company paid the additional tax and sued to recover it back on the ground that the company had not received any sum to the extent that the dividends operated "to abate or reduce the stipulated premium". DISTRICT JUDGE CROSS sustained the company's position in a decision filed July 29, 1912.

Mutual Benefit Life v. *Herold,* 198 Fed. 199.

It was the opinion of JUDGE CROSS in this *Mutual Benefit* case and the authority given to it by the Court of Appeals adopting it that suggested to Congress this clause in the law. In that opinion, JUDGE CROSS not merely discussed with

"fullness and ability" the principles underlying life insurance on the mutual, level premium, plan, but made it clear,—

FIRST: That in mutual insurance on the level premium plan each policyholder is entitled to his insurance at cost.

SECOND: That each insured pays in advance an estimated sum which is more than cost is expected to be, but which will be adjusted to cost when the experience of the year discloses the true cost; that the difference between the estimated sum paid in advance and cost belongs to the policyholder, not to the company; and that the company must account to the policyholder for all that he paid it in excess of cost.

THIRD: That the over-payment of premium does not "in any wise, or to any extent, represent earnings or profits received by the company so as to constitute it a part of its income".

To show the soundness of his conclusions, JUDGE CROSS not only explained how premiums are calculated, how the business is done and the amount of the over-payments ascertained and held to the use of the insured, but he quoted extensively from decisions of the courts of England and America the authority of which he said was enhanced by the fact that there were no conflicting decisions. Among other things JUDGE CROSS said,—

> "This excess payment represents, not profits or receipts, but an over-payment—an over-payment because, being entitled to his insurance at cost and having paid more than it cost, he is equitably entitled to have such excess applied for his benefit. It makes no difference what this excess is called. The question is, What does it represent? Does it in any wise or to any extent represent earnings or profits received by the company, so as to constitute it a part of its income; or does it merely represent an over-payment?"

And he went on to show that these excess payments did not in any wise or to any extent represent profits or earnings

received by the company, or constitute a part of its income, but merely represented over-payments. He quoted from *Mutual Benefit Life* v. *Commonwealth,* 128 Ky. 374, where the court held that where a previous over-payment is treated as an abatement of premium "All that the insurance company receives in cash or otherwise is this difference".

And he quoted also from *Commonwealth* v. *Penn Mutual Life,* 1 Daugh Co. Rep. 233 (Pa), where that court said,—

> "But we think the so-called dividends to policyholders are not net earnings or income."

And after quoting from other American decisions in support of his conclusions, JUDGE CROSS then turned to the English cases and quoted from them extensively, especially the following from Lord MacNaughten in *New York Life* v. *Styles,* 14 App. Cas. 381, decided in 1887, and involving the application of an English Income Tax Act to a mutual life insurance company,—

> "They contribute according to rates fixed by approved tables, and they invite other persons to come in and join them by insuring their lives on similar terms. The rates fixed by the tables are taken as being sufficient to provide for expenses, to meet liabilities, and to leave a margin for contingencies. What is to become of the surplus, if everything goes right? The practice is to take an account every year of assets and liabilities, and to give the insured the benefit of the surplus, either by way of reduction of premium or by way of addition to the sum insured. It can make no difference in principle whether the surplus is so applied or paid back in hard cash. In either case it is nothing but the return of so much of the amount contributed as may be in excess of the amount really required. I do not understand how this excess can be regarded from any point of view, or for any purpose, as gain or profit earned by the contributors."

To tax income, the first duty of Congress was to find out what was income. When they reached life insurance, the authors of the tax bill had before them JUDGE CROSS' opinion

in the *Mutual Benefit* case, and the opinion of the Court of Appeals approving and adopting it. There they found out that these annually ascertained over-payments of premium were not income of the company at all. Hence, they said, we will not include them in income, or try to tax them as income.

The issue in the *Mutual Benefit* case dealt only with these over-payments when treated as an abatement of premium. But JUDGE CROSS had made it clear that they did not "in any wise, or to any extent, represent earnings or profits received by the company so as to constitute it a part of its income". Therefore, they said, we will frame a clause that will cover every possible case. And so they adopted the all-embracing language of this clause, excluding them from income whether they were paid back, or credited, or, as in the *Mutual Benefit* case, treated as an abatement of premium.

Dividends they put on a different basis. They were unwilling to deduct these. Why? Because to deduct dividends would discriminate between companies,—against the purely annual dividend companies and in favor of companies that had issued both annual and deferred dividend policies; for the dividends on deferred dividend policies were always more in any year than the portions of actual premiums credited that year to deferred dividend policies because the deferred dividends contained interest accumulations during the period the over-payments were held as a credit. For instance, the dividends the petitioner paid its deferred dividend policyholders in 1913 amounted to (R. 30) $9,594,009.64, while the over-payments of premiums that year credited were only $8,189,-918,—a difference of $1,404,091.64 in favor of the deferred dividend company. Whereas, if all companies were limited in the exclusion from income to the portions of actual premium received in excess of cost, there would be no discrimination between them. All would be treated alike.

Hence, in the Act of 1913 they re-enacted the clause contained in the Act of 1909, namely, that life insurance com-

panies shall deduct "the sums other than dividends paid within the year on policy and annuity contracts", and they added this clause to exclude from income what the court had shown in the *Mutual Benefit* case was not income of the company, and to exclude it in such a way as not to discriminate between companies but to treat all mutual companies alike.

III.

The aptness of the language used in this clause to do just what Congress intended by it to do and what the petitioner claims it does.

> "Nothing is better settled than that, in the construction of a law, its meaning must first be sought in the language employed. If that be plain, it is the duty of the courts to enforce the law as written, provided it be within the constitutional authority of the legislative body which passed it."
>
> *United States* v. *Standard Brewery,* 251 U. S. 210.

The policyholders paid their premiums in 1912. At the end of the year, that is, in 1913, the petitioner made the customary accounting. The accounting disclosed the amount the policyholders paid in excess of the cost of insurance. The total sum so over-paid the petitioner apportioned among the individual policyholders who over-paid it, and credited each individual policyholder on the form in use for this purpose with the over-payment made by him on each one thousand dollars of his insurance.

With technical accuracy the law describes this as a portion of actual premium received from each individual policyholder which was credited to such individual policyholder within the taxing year.

The over-payments so credited (R. 44) "when multiplied by the number of thousands of dollars of deferred dividend

insurance in each year of issue on each insurance plan and at each age at issue, equaled precisely said sum of $8,189,918 when the sums so multiplied were all added together".

Could anything be plainer than this? Could anything more clearly describe just what sums make up this $8,189,918 than does this clause of the law?

Each and every sum that enters into it is a portion of an actual premium received from an individual policyholder which was credited to such individual policyholder within the taxing year, and nothing else.

On first reading the clause, there seems to be in it one ambiguity. That is, whether or not the portion of premium must be both received and credited within the taxing year. But a little reflection promptly clears up this apparent ambiguity. For eveybody knows, no part of any premium is ever paid back, credited or treated as an abatement of premium in the year in which the policyholder pays it. He pays the premium in one year, the accounting is taken after the end of the year, and the amount of the over-payment, if any, thereby ascertained is then paid back, credited or treated as an abatement of premium. This is necessarily true of all policies, both annual and deferred dividend policies. Hence the clause would have no meaning at all for any policy or for any company if it required the portion of premium to be both received and credited within the taxing year.

Without any ambiguity and in the fewest possible words the clause excludes from income what the court had shown in the *Mutual Benefit* case was not income of the company, and describes perfectly the sum in dispute here.

IV.

Penn Mutual Life Insurance Co. v. _Lederer_, 252 U. S. 523, has nothing to do with the issue in this case. That case was about dividends; this is not.

As I understand the trial court's opinion, the learned Judge thought the question here was the same as in the *Penn Mutual* case and was controlled by that decision (R. 135). The Circuit Court of Appeals appears so to have understood the trial court's opinion (R. 165).

The Circuit Court of Appeals saw that the question here was not the question that was before the court in the *Penn Mutual* case (R. 167) and yet the majority of the court seem to have made the *Penn Mutual* case (R. 171 *et seq.*) the ground of their decision.

Now what was the issue in the *Penn Mutual* case?

The Penn Mutual is a mutual company and transacts its business on the same general plane as the petitioner. In the taxing year undoubtedly it took an account of its business and thereby ascertained how much its policyholders had over-paid it and apportioned among them and credited to them individually, as the petitioner did, these several sums. What was the total amount of these portions of actual premiums received and credited, and what the Penn Mutual did about them in its tax return, I do not know because the record in that case does not show. It says nothing at all about them. It is on an entirely different subject.

Here was the issue in the *Penn Mutual* case,—Some of the Penn Mutual's deferred dividend policies required it during the taxing year to pay a dividend on these policies;—a dividend made up (1) of the total amount of annually ascertained and credited portions of actual premiums received in all the past years of the policy, plus (2) the interest accumulations thereon, plus (3) the policyholder's proportionate share of the accumulated over-payments of the members of his class who had died or lapsed their policies. The Penn

Mutual declared and paid such dividends on these policies, and in making its income tax return the company deducted from its gross income the total amount of these dividends paid during the year. The question in the case was as to whether or not this clause of the law justified the company in not including these dividends in its gross income for the year, and the court held that it did not; and it so held because such dividends were dividends and not, as here, exclusively portions of actual premiums received from individual policyholders which were paid back, credited or treated as an abatement of premium within the taxing year, and because another clause of the law expressly said insurance companies should not deduct dividends.

Because the court has held in the *Penn Mutual* case that one sum made up in one way and not at all conforming to the sum described in this clause of the law and in dispute here, does not come within this clause of the law, is this any reason why the sum in dispute here, differently made up and entirely composed of portions of actual premiums received from individual policyholders and credited to such individual policyholders within the taxing year, does not come within this clause of the law which so perfectly describes it?

V.

The *Penn Mutual* Case controlled the decision of the trial court and misled a majority of the Court of Appeals who by their decision practically eliminated from the statute the word credited, which was especially intended to apply to deferred dividend policies.

1. The trial court, after quoting at some length from the Supreme Court's opinion in the *Penn Mutual* case, says (R. 134, f. 400),—

> "If the Company may not deduct from its income actual cash returns made to deferred dividend policy-

> holders on account of the redundancy of the premiums, it would seem to follow that the Company should not be permitted to exclude from its income for the year the ascertained over-payments of premiums for the previous year or years when in the year in question neither was cash returned to the policyholders nor was any abatement or reduction made in the premiums paid by such policyholders during the year."

Because this clause of the law does not authorize the Company to deduct from income dividends paid to deferred dividend policyholders, why does it "seem to follow that the Company should not be permitted to exclude from its income for the year the ascertained over-payments of premiums" of individual policyholders which were credited to them within the taxing year? I do not see.

Dividends are one thing. The law says insurance companies shall deduct "the sums other than dividends paid within the year on policy and annuity contracts". Over-payments of premiums are quite another thing. The law says "life insurance companies shall not include as income in any year such portion of any actual premium received from an individual policyholder as shall have been * * * credited to such individual policyholder * * * within such year."

The all-sufficient reason, therefore, for treating dividends one way and portions of actual premiums received and credited another is, because the law says so. It is not left to judicial discretion or to our conflicting notions of logic.

2. The Circuit Court of Appeals saw that (R. 162) "the question which was before the court in that case (the *Penn Mutual* case) is not the question which is before the court in the instant case"; and yet, after so stating, the learned court quoted at length from the decision of the court in the *Penn Mutual* case, and then said (R. 173),—

> "It seems to us clear that a dividend to constitute a credit in the tax year which may be deducted from or non-included in the premium paid by an individual

> policyholder in said year must be such a credit to such individual policyholder as effects a reduction in the amount of premium received by the company from such individual policyholder and must be the equivalent of a cash payment to or an abatement of premium of such individual policyholder."

Now just stop to consider that a moment.

In the first place, we do not claim the right to have *dividends* deducted or non-included. That is not the question in the case.

But in the second place, How would you make a credit so as thereby to effect "a reduction in the amount of premium received"? It would then be a payment,—"treated as an abatement of premium".

Or how could a credit "be the equivalent of a cash payment"? A credit can be nothing more than a written admission of an indebtedness to the person credited. It is never the equivalent of cash, and certainly could not be the equivalent of cash so as correspondingly to reduce the premium receipts of the company, which, as I understand the court's conclusion, is the only sort of credit the court thinks this clause means.

Suppose these credited over-payments could not be lost to the policyholder by any future contingency except the insolvency of the company, would they then be the equivalent of cash, or reduce by one penny "the amount of premium received by the company"?

Clearly the decision of the court gives this common word, credited, intended in this statute to be of so much importance and to put all mutual companies and all policyholders on a plane of perfect equality, no practical meaning or effect at all.

Is it unfair to assume that the authors of this law knew something about the business of life insurance? If they did, nay even if they merely knew what everybody knows, they knew there were both annual and deferred dividend policies, and that some companies wrote only the one and others

both; they knew that the over-payments on annual dividend policies were each year paid back or treated as an abatement of premium; and on deferred dividend policies were always each year credited. If, therefore, they had intended this clause to apply only to annual dividend policies, they would not have used the word credited at all; paid back or treated as an abatement of premium would have accomplished what they wanted to do. But it was not their intention that this clause should apply to the over-payments on annual dividend policies only; it was their intention to treat all companies and all policyholders alike. Hence they used the word credited for the special purpose of including the over-payments of deferred dividend policyholders too.

VI.

The over-payments were credited to each individual policyholder.

This, I think, has been made clear enough in the statement of facts in this brief. I recur to it here again, because the Court of Appeals said in its opinion at page 170,—

> "The credit in this case was never given to individual policyholders as respects the controverted sum of $8,189,918. What really happened was that the credit was given to a class to which the individual holder belonged."

If this is so, what did the parties to this suit mean when in their agreed statement of facts they said (R. 44),—

> "By a like mathematical calculation, the plaintiff ascertained the amount of over-payment made by each deferred dividend insured on each one thousand dollars of insurance for each year of issue on each insurance plan and at each age at issue. The over-payment so ascertained, when multiplied by the number of thousands of dollars of deferred dividend insurance in each year

of issue on each insurance plan and at each age at issue, equaled precisely said sum of $8,189,918 when the sums so multiplied were all added together. This rate of overpayment for each one thousand dollars of insurance the plaintiff recorded on a form in use for that purpose, and bound these forms together, each year of issue making a separate volume?"

If the credit was not given to individual policyholders what does Exhibit 5 mean?

If a policyholder asks the petitioner the amount of overpayment held to his credit, what does the petitioner mean by going to its credit volume of which Exhibit 5 is an illustration, there getting the sum credited to him in the year of the inquiry and the accumulated sum held at the commencement of the year and advising him of both with the rate of interest they draw (R. 50, 51)?

To be sure the petitioner did not enter these individual credits anywhere else, but why should it? Would that have made them any more of a credit? Are two credit entries better than one?

Suppose the petitioner had carried these credits from the credit volume in which it originally entered them to the premium notice card of each policyholder as it did in the case of annual dividend policies (R. 43, f. 128 *et seq.*) for the sole purpose of making out the premium notice, would this have made them any more of a credit?

Is it any more an individual credit to write on the premium notice card of each individual policyholder whose policy is on the ordinary life plan taken out in 1905 at age 21 "Div. Rate per M 1913 $3.40" than it is to enter in a form in use for this purpose that each individual policyholder whose policy was taken out in 1905 on the ordinary life plan at age 21 is credited with "Div. Rate per M 1913 $3.40"? The two forms of credit are equally intelligible, but which one of them would an office efficiency expert approve?

But the respondent criticises this credit because the credit is given for each one thousand dollars of insurance and the

multiplication is not actually made and recorded for each policy. Years ago that would have been done and the total product entered in the policyholder's ledger account. But we believe we have made progress in our accounts; and if we had not, insurance would now cost a lot more than it does. We do not now keep ledger accounts with any policyholder. So far as I know, no company does.

Now, so much for each $1,000 of insurance is the method used wherever and whenever possible, because it saves time, trouble, expense and mistakes. Its use is illustrated by a no less important and formal document than the petitioner's policy contracts themselves. These contracts, in stating the Cash Surrender Value, the Loan Value, and the Paid-Up Insurance Value do not undertake in the policy to give the total of any one of these. Whatever the amount of the insurance, the policy gives each of these for only $1,000 of insurance, and tells the policyholder to multiply by the number of thousands of dollars of insurance under the policy to get the total of each. The form is in the record at page 107, folio 302, as follows,—

> "TABLE OF LOAN AND SURRENDER VALUES
>
> "The Cash Surrender, Loan, and Paid-up Insurance Values stated in the following table apply to a policy of $1,000. As this Policy is for $, the Cash Surrender Value and Loan Value (Col. 1), and the Paid-up Insurance (Col. 2), will be the amounts stated in the table; the periods of Continued Insurance (Col. 3) must not be multiplied or increased."

Now let us assume a policyholder insured for $10,000 lapses his policy after paying premiums enough to purchase $500 paid-up insurance for each $1,000 of the policy. Shall we be heard to say that the petitioner did not in such contract agree to give $5,000 paid-up insurance, or to pay $5,000 on the death of the insured, because the policy merely said that in the event of lapse the insured would be entitled to $500 paid-up insurance for each $1,000 of the policy?

This method of giving in the policy the Cash Surrender Value, the Loan Value, and the Paid-up Insurance Value not based on the face of the policy but for each $1,000 of insurance is employed for precisely the same reason as the same method is employed in crediting the portions of actual premiums received in excess of the cost of insurance, namely, to save time, trouble, expense and mistakes,—each of them important items of saving in any large business, but especially important in the business of life insurance with its complicated office details, simplify them as best we can.

Suppose an ordinary life policyholder whose policy was taken out in 1905 at age 21 sued the petitioner to recover the portion of actual premium received from him and credited to him in 1913, and the petitioner made no defense except that there was no over-payment credited to him in 1913, what would the court say, or a jury if you please, when the policyholder required the petitioner to produce Exhibit 5 and put it in evidence? I think I need not suggest any answer to this question or further elaborate this thought here.

That the petitioner (R. 44) merged the total individual credits into the entire accumulated sum held for ultimate division among and payment to its deferred dividend policyholders is quite true. If it had not done so, the total amount of the individual credits would have become a part of the general funds of the petitioner. But these over-payments did not belong to the petitioner's policyholders as a whole; they belonged to those policyholders only whose over-payments they were. Hence the petitioner (R. 44) created a special account into which it merged each year the aggregate of all such credited sums and held them to the use of the several policyholders to whom they belonged. It gave individual credits, and kept the money credited to pay the persons credited when the pay day came.

VII.

The credited over-payments are none the less credits because the policyholder may lose his credit by dying or lapsing his policy before the dividend date named in it.

1. The Court of Appeals says (R. 170),—"We think the phrase 'credited' to the 'individual' policyholder means finally and irrevocably credited".

Why? What does the statute say to suggest any limitation or qualification of the plain meaning of the words in common use it contains? Especially what does it say to suggest, much less to justify, a meaning that destroys its practical effect and defeats its true purpose and intent?

Moreover, the government which framed this statute for its own benefit had a free field for limiting or qualifying the word credited if it wanted to do so, and the fact that it did not is conclusive evidence that it did not want to.

The rules you apply in construing a taxing statute which the government drew for its own benefit are closely akin to the rules which obtain in construing a life insurance policy and for the same good reason. Such a statute is strictly construed in favor of the taxpayer, not against it. If its meaning is doubtful, the taxpayer, not the government, is given the benefit of the doubt. The literal meaning of the words employed is most important.

United States v. *Merriam*, 263 U. S. 179;
Gould v. *Gould*, 245 U. S. 151;
Spreckles Sugar Co. v. *McLane*, 192 U. S. 397;
American Net & Twine Co. v. *Worthington*, 141 U. S. 468;
United States v. *Wigglesworth*, 2 Story 369;
Converse v. *Northern Pacific Ry. Co.*, 2 Fed. 2d. 959;
Penn Steel Co. v. *N. Y. C. Ry Co.*, 198 Fed. 774;
Park View B. & L. Ass'n. v. *Herold*, 203 Fed. 876.

The conclusion of the Court of Appeals, that credited "means finally and irrevocably credited", is inconsistent with each of these rules as well as contrary to the plain language of the law.

2. But why should a credit be any less a credit because it is subject to be lost by the happening of a condition subsequent?

When the amount of the over-payment is first ascertained it is credited to each individual policyholder and will be paid with interest to each such policyholder whose insurance is in force on the date agreed upon in the policy for returning it to him, plus his proportionate share of the accumulated credits of those of his class who lost their credits by dying or lapsing their policies.

Suppose A borrows from B one thousand dollars and gives him for it his note in which A promises to pay B one thousand dollars ten years after date, with five per cent interest compounded annually, provided B is then living,—otherwise to X, Y and Z who are like borrowers. By this transaction does not B have a credit with A? If not, why not? Certainly he has a credit, a valuable credit, which B can sell and transfer at any time in the market;—not perhaps as readily or for as high a price as a credit not subject to be lost, but none the less B has a salable credit with A.

Or suppose you deposit in bank a sum of money and the bank agrees to hold and accumulate it and return it to you on a fixed date if you are then living, but not otherwise, together with your proportionate share of the deposits of other persons who have made deposits on similar terms,—by such deposit would you have no credit in the bank? If the money you thus deposited was not a credit to you, what was it? What was the relation between you and the bank? Was it not the same as that of any depositor, the relation, namely, of creditor and debtor? Were you not credited by the bank with the sum of money which it received from you and which it was under contract obligation to return to you if you were

living, or to pay to another if you were not living, on an agreed date?

Just so are these portions of actual premiums received from individual deferred dividend policyholders and credited to them within the taxing year. When the amount of the over-payment is ascertained and credited, and the contract is that the petitoner shall hold and accumulate the over-payment at interest to an agreed date, the policyholder becomes a depositor with your petitioner to the extent of the credited over-payments; and your petitioner must ultimately return the credited sum to the policyholder unless, in accordance with the terms of the contract under which he made the deposit, it goes to other like creditors of his class because of the happening of a condition subsequent, namely, his death or the lapse of his policy before the settlement date named in the contract.

VIII.

To hold that this clause applies to annual dividend policies only and not equally to deferred dividend policies is not merely contrary to the plain and unambiguous terms of the law, but discriminates (1) between taxpayers of the same class, and (2) between different groups of policyholders of the same taxpayer.

Some companies doing business on the mutual, level premium plan—such as the Mutual Benefit, the Connecticut Mutual, the Home Life of New York, the Massachusetts Mutual, the Provident Life and Trust, and many others—have issued only the so-called annual dividend policies; some other like companies—such as the Northwestern, the Penn

Mutual, the Union Central, the National Life of Vermont, and many others—have, like your petitioner, issued policies on both of these plans.

1. This law as now construed discriminates between companies.

It imposes a tax upon your petitioner and other companies similarly situated which is not imposed at all upon like mutual companies which issued only annual dividend policies. In other words, the Mutual Benefit, the Connecticut Mutual and all other annual dividend companies deduct each year from gross income 100% of the over-payments made by their policyholders; but this company and others with deferred dividend policies on their books cannot do this; they can only deduct a part of the over-payments,—in 1913 for this company 41% only (R. 42), and in each subsequent year a similar percentage.

The resulting tax in 1913 by this discrimination, $81,899.18, is not a serious thing in competition,—its worst phase is its illegality and its injustice. But when we come to later years, $1,739,243.91 in 1918, the illegal discrimination becomes more than an injustice, it becomes a telling talking point for our competitors. Say the agents of our competitors,—"How can you expect the New York Life to insure you at as low a cost as my company can do when you think of the taxes it has to pay which my company does not have to pay at all? Why, in one year that company was taxed $1,739,243.91 where my company was not taxed a cent." How can our agents answer this? They cannot answer it, because it is true.

2. It discriminates also between policyholders.

Under the court's construction, the annual dividend policyholder gets back his over-payments free from any tax; the deferred dividend policyholder does not; his over-payments are taxed, this tax is deducted from them and the balance

returned,—a less sum than was returned to the annual dividend policyholder whose premium and whose over-payments were the same. That is, this law as so construed makes the insurance of one policyholder cost him more than does the insurance of another policyholder of the same class and equal expectation of life.

Discrimination in mutual insurance is so objectionable that nearly all the states have passed laws forbidding life insurance corporations, under heavy penalty to "make or permit any discrimination between individuals of the same class or of equal expectation of life".

New York Insurance Law, Section 89.

Did Congress intend to discriminate between them? I do not belief so. There is nothing in the law to indicate such intention. Everything in the law indicates an intention to put all companies and all policyholders on a plane of perfect equality.

3. I do not point out the unequal and discriminatory effect of the present construction of this law to try to induce the court to put into it some meaning which the Congress did not put into it. What I am asking for is the administration of this law just as it is, and according to its plain terms and the undoubted intent of Congress.

But if the meaning of the law were doubtful or its intent uncertain, the court would not, if it could avoid it, construe it so as to discriminate between companies and between policyholders, as the present construction does.

> "Where a particular construction of a statute will occasion great inconvenience or produce inequality and injustice, *that view is to be avoided if another and more reasonable interpretation is present in the statute.*"
>
> *Knowlton* v. *Moore*, 178 U. S. 41, 77.

Unless they are forced to a contrary conclusion, the courts always assume that it is impossible that Congress should

have intended any unequal, inequitable, or discriminatory results.

Church of Holy Trinity v. *U. S.*, 143 U. S. 467;
Haydenfeld v. *Dancy & Co.*, 93 U. S. 634;
United States v. *Kirby*, 7 Wall. 482;
Smythe v. *Fish*, 23 Wall. 374;
Lau Ow Bew v. *United States*, 144 U. S. 47;
Hawaii v. *Mankichki*, 190 U. S. 197.

When, therefore, Congress said, "life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been * * * credited to such individual policyholder * * * within such year", it meant exactly what it said. It had before it the *Mutual Benefit* case which involved only over-payments made in the previous year "treated as an abatement of premium" in the taxing year, and in which the court made it perfectly clear that these over-payments, deceptively styled dividends, were not dividends at all, but were the policyholder's own money which he had turned into the Company,—not because the Company was entitled to it as its own, but because there was no way of knowing in advance the exact sum the policyholder ought to pay; and so he paid in advance an estimated sum and agreed to wait until, at the end of the year, the Company found out what was its actual experience, what was the exact sum chargeable to each policyholder as actual cost to him for the year,—the difference between the estimated sum paid in advance and actual cost as ascertained by experience constituting the policyholder's own money, to remain as a credit to him until returned to him or otherwise disposed of in accordance with law and his contract,—the over-payment in no event being income of the Company.

Hence, Congress reasoned, if these over-payments are not taxable when "treated as an abatement of premium", they ought not to be taxed when paid back or credited. And so, in framing the new law Congress followed the logic, not merely

the law, of the *Mutual Benefit* case. It undertook to put all companies and all policyholders on an equality by not including as income any over-payments of premium, whether the over-payments were paid back, or credited, or, as in the *Mutual Benefit* case, treated as an abatement of premium. Congress did not intend to discriminate either between rival companies, or between different policyholders in the same company. A construction of the law which makes such a discrimination is a misconstruction of it, and is contrary to its plain meaning and intent.

Second.

As to losses sustained by the amortization of securities purchased above par.

Subdivision 2-G(*b*) of the Revenue Act of 1913 authorizes the deduction from gross income of "all losses actually sustained within the year and not compensated by insurance or otherwise".

The petitioner each year amortizes its securities purchased at a premium and treats the deduction from the premium paid as an annual loss. In making its return it deducted from its gross income the total loss by amortization, as it believed itself authorized to do by the clause of the law above quoted.

The respondent claims this procedure was wrong,—that what the petitioner should have deducted was the amount of the premium paid on only those securities purchased above par that became due in the taxing year. Or to quote from respondent's brief in the Court of Appeals,—

> "Plaintiff, of course, would be entitled at the maturity of the bond to deduct the whole amount of the premium which it had been required to pay for the bond, this for the reason that its loss would be actually sustained as of that date."

The respondent's view expresses what I understand to be the Commissioner's rule.

The petitioner's method of taking this loss annually instead of taking it at the due date of the security is the method followed by all large investors. Indeed, the laws of New York require it of insurance companies.

Section 18 of *The Insurance Law of New York* says,—

> "All bonds or other evidences of debt held by any life insurance corporation authorized to do business in this state shall, if amply secured and if not in default as to principal or interest, be valued as follows: If purchased at par, at the par value; if purchased above or below par, on the basis of the purchase price adjusted so as to bring the value to par at maturity and so as to yield meantime the effective rate of interest at which the purchase was made".

And the laws of many other states contain like requirements.

The valuation here referred to is the yearly valuation; the loss is the yearly loss. This practice obtained and such laws were in force at the time the Congress passed this law, and Congress is presumed to have legislated with reference to the prevailing business customs and the legal requirements imposed upon business at the time the law was passed.

This question often arises in trust estates. In such cases the rule observed is the same as that followed by your petitioner and other investors. In *Matter of Stevens,* 187 N. Y. 471, the court said at page 475,—

> "Where trust funds are invested by the trustee in bonds having a term of years to run and purchased at a premium, such a proportionate deduction should be made from the nominal interest as will, at the maturity of the bonds, make good the premium paid, and thus preserve the principal of the fund intact."

In *New York Life & Trust Co.* v. *Baker,* 38 A. D. (N. Y.) 417, the court in an opinion which the Court of Appeals approved and affirmed in *New York Life & Trust Co.* v. *Baker,* 165 N. Y. 484, said at page 423,—

> "There is an intrinsic change in the value of a security for the payment of money, bought either at a premium or a discount, as it approaches maturity, which is perfectly susceptible of calculation."

And that is just what we claim here. On securities purchased at a premium there was an intrinsic change in the value of the securities each year which was perfectly susceptible of calculation; and the aggregate sum shown by the petitioner's return was the true amount of the intrinsic change and actual loss on securities purchased at a premium.

Assume a bond for $1,000 due in ten years purchased at a price of $1,100. At the maturity of this bond after ten years, the purchaser will receive for it only $1,000, thus sustaining an actual loss of $100. When did this loss occur? We claim, and the practice and understanding of the business world supports the claim, that the loss occured proportionately each year. The bond was worth 110 when purchased. A year later it would be worth less, about 109; another year later still less, about 108, and so on until the time of the bond's maturity, when it would be worth only par, the amount received for it on the date it became due.

No authoritative decision has been made on this subject by the federal courts. The Court of Appeals of the Seventh Circuit in an opinion by Circuit Judge Page refused to allow the deduction, but gave no reason for so holding.

> *Fink* v. *Northwestern Mutual Life Insurance Co.*, 267 Fed. 968.

But in that case the District Court in its opinion made no reference at all to the subject, which would indicate that it must have come up in an incidental way in the Court of Appeals, and for this reason was not discussed by the court and probably not by counsel.

> *Northwestern Mutual Life* v. *Fink*, 248 Fed. 568.

In this case, two Circuit Judges, Mack and Hough, sustained the petitioner's view, and two Circuit Judges, Rogers and Hand, rejected it. But Mr. Circuit Judge Rogers in his opinion discusses the subject as if petitioner were claiming under the clause of the law which allows a deduction for

depreciation. This is not our claim and has not been. Our claim is that it is a loss actually sustained; and the respondent has never denied the loss, but has only disputed as to the time when the loss occurs. And yet, as I understand the opinion of the learned Circuit Judge, all that is said on the real issue is (R. 176) "Neither do we think that it is a loss actually sustained during the year."

On the other hand, contrast with this Judge Mack's view (R. 137),—

> "It has already been pointed out, however, that the amortization in question is not a revaluation to reflect market changes. It is a computation to distinguish the payment back of a portion of a capital investment from the interest or yield. It need not be assimilated to depreciation at all. In computing the return or income from bonds purchased at a premium, as a matter of economics an allowance must be made from the nominal interest paid to permit the amortization of the premium by maturity."

It seems to me Judge Mack clearly understands this issue. Securities sell at a premium because they are sound and pay a high interest return. A part of the high interest return must be put aside each year to reimburse for the premium paid, that is, for the yearly loss of the premium. But the entire interest was taxed as income. Hence, if the part of the interest used to reimburse for the yearly loss of premium is deducted, then by the deduction only that part of the interest is taxed which was in fact interest income.

The choice between the Commissioner's method of making this deduction and the petitioner's would probably amount to little or nothing as to the difference in the tax. The present difficulty is in making the change. It is now, I suppose, too late to readjust the assessment; and the practical effect of an adverse judgment will be to exact from the petitioner, on purely technical grounds, a tax which it was not legally liable to pay.

When, therefore, we take into account the present situation and consider,—

1. That the loss as the petitioner took it conformed to the universal practice and the requirements of law both now and when Congress passed this Act;

2. That a proportionate part of the loss is actually sustained each year;

3. That the practice the petitioner followed is the same as that applied in administering trust estates with the approval of the courts,—

the court should approve the deduction as made by the petitioner rather than as the Commissioner would make it.

Respectfully submitted,

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16 December, 1925.

Appendix I.

Revenue Act of 1913
(38 Stat. at Large, 114 Chap. 16 at page 172, Federal Statutes Annotated, Vol. 4, p. 245).

"G. (*Tax on net incomes of corporations.*) (*a*) That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation, joint-stock company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships; but if organized, authorized, or existing under the laws of any foreign country, then upon the amount of net income accruing from business transacted and capital invested within the United States during such year; *Provided, however,* That nothing in this section shall apply to labor, agricultural, or horticultural organizations, or to mutual savings banks not having a capital stock represented by shares, or to fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident and other benefits to the members of such societies, orders, or associations and dependants of such members, nor to domestic building and loan associations, nor to cemetery companies, organized and operated exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual, nor to business leagues, nor to chambers of commerce or boards of trade, not organized for profit or no part of the net income of which inures to the benefit of the private stockholder or individual; nor to any civic league or organization not organized for profit, but operated exclusively for the promotion of social welfare: *Provided further,* That there shall not be taxed under this section any income derived from any public utility or from the exercise of any essential governmental function accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State, Territory, or the

District of Columbia, nor any income accruing to the government of the Philippine Islands or Porto Rico, or of any political subdivision of the Philippine Islands or Porto Rico: *Provided*, That whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, has, prior to the passage of this Act, entered in good faith into a contract with any person or corporation, the object and purpose of which is to acquire, construct, operate or maintain a public utility, no tax shall be levied under the provisions of this Act upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, or the District of Columbia, or a political subdivision of a State or Territory; but this provision is not intended to confer upon such person or corporation any financial gain or exemption or to relieve such person or corporation from the payment of a tax as provided for in this section upon the part or portion of the said income to which such person or corporation shall be entitled under such contract.

(*b*) Such net income shall be ascertained *by deducting from the gross amount of the income of such corporation,* joint-stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property; (second) *all losses actually sustained within the year and not compensated by insurance or otherwise,* including a reasonable allowance for depreciation by use, wear and tear of property, if any; and in the case of mines a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made; and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and *the sums other than dividend paid within the year on policy and annuity contracts: Provided,* That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources

plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further,* That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof *and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year;* (third) the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding one-half of the sum of its interest bearing indebtedness and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of its indebtedness not exceeding the amount of capital employed in the business at the close of the year: *Provided,* That in case of indebtedness wholly secured by collateral the subject of sale in ordinary business of such corporation, joint-stock company, or association, the total interest secured and paid by such company, corporation, or association within the year on any such indebtedness may be deducted as a part of its expense of doing business: *Provided further,* That in the case of bonds or other indebtedness, which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed shall be allowed; and in the case of a bank, banking association, loan, or trust company, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the Government of any foreign country."

Appendix II.

Revenue Act of 1909,
(Federal Statutes Annotated, Vol. 4, p. 255.)

Sec. 38 (*Excise tax on corporations.*) That every corporation, joint stock company or association, organized for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States or of any State or Territory of the United States or under the Acts of Congress applicable to Alaska or the District of Columbia, or now or hereafter organized under the laws of any foreign country and engaged in business in any State or Territory of the United States or in Alaska or in the District of Columbia, shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint stock company or association, or insurance company, equivalent to one per centum upon the entire net income over and above five thousand dollars received by it from all sources during such year, exclusive of amounts received by it as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax hereby imposed; or if organized under the laws of any foreign country, upon the amount of net income over and above five thousand dollars received by it from business transacted and capital invested within the United States and its Territories, Alaska, and the District of Columbia during such year, exclusive of amounts so received by it as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax hereby imposed: *Provided, however,* That nothing in this section contained shall apply to labor, agricultural or horticultural organizations, or to fraternal beneficiary societies, orders, or associations, operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders or associations, and dependents of such members, nor to domestic building and loan associations, organized and operated exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.

Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint stock company, or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and opertaion of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, *and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts* and the net addition, if any, required by law to be made within the year to reserve funds; (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year, and in the case of a bank, banking association or trust company, all interest actually paid by it within the year on deposits; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the government of any foreign country as a condition to carrying on business therein; (fifth) all amounts received by it within the year as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax hereby imposed:"